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# MONETARY GOLD AND ITS ROLE IN TRANSFORMATION PROCESSES IN THE INTERNATIONAL MONETARY SYSTEM

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## ABSTRACT

The international monetary system has entered a period of transformation, characterized by the decline in the US dollar's dominance and an obvious increase in the interest of the world community in monetary gold as a reliable reserve asset. However, further reflection is needed on the role of gold in the transformation process and the optimal size of the gold reserves of central banks, and this is *the aim of the study*, the first results of which are presented in the article.

As the fundamental principle of understanding socio-economic phenomena and processes is their explanation through internal contradictions, the *methodological framework for the study* involves the methods of observation and data collection and analysis, based on the empirical approach to economic research.

*The results of the performed analysis* indicate the beginning of a new stage in the accumulation of gold reserves by central banks all over the world, reflecting the growing importance of monetary gold in the monetary and financial system in today's world order.

The authors *believe that gold is back on its pedestal as the most reliable asset* that will be able to withstand global financial crises, and the country with the largest gold reserves will undoubtedly win, as it will be able to overcome the negative shocks.

## INTRODUCTION

There have been a lot of discussion lately on the ongoing dedollarization in the world economy and the replacement of the dollar, on the one hand, with national currencies in settlements between countries, and, on the other hand, with gold as a traditional form of global money. This trend is proved by the change in the volumes of gold at the disposal of the Bank for International Settlements for SWAP transactions, during which currencies are exchanged for physical gold, from 503.07 t in 2013 to 102 t by the beginning of 2020 (1), which, in our opinion, was the result of operations to close the trade deficit by a number of countries in the face of economic sanctions imposed by the United States in 2014. Another indicator of the declining importance of the dollar in the world is the spontaneous process of introducing a golden anchor for electronic money (digital gold currencies), as well as the introduction of so-called stablecoins (cryptocurrencies backed by real assets, primarily monetary gold) into circulation. The growing interest in monetary gold among investors is also evidenced by the long-term upward trend in monetary gold quotes in international markets. Understanding that monetary gold can maintain its purchasing power and sustainable demand, central banks are increasing volumes of gold reserves, diversifying their international reserves. Thus, in 2019 Kazakhstan increased the share of gold in its reserves from 40.7% to 64.9%, Portugal — from 58.1% to 77.1%, Austria — from 51% to 57.8, Turkey — from 13.2% to 21,9%, China — from 1.4% to 2.9%, and Russia — from 17.7% to 19.9% (2; 3).

Therefore, we can assume that, in international monetary and credit relations, the gold, officially demonetized in 1978 by the ratification of the agreements reached at the IMF International Conference in Jamaica, is resuming its monetary role, which gives rise to predictions by some reputable experts, including Robert Zoellick, on the likelihood of a return to the gold standard in the international monetary system, although in a limited scope (4).

However, it has been theoretically substantiated and practically proven that the current state and level of development of the reproductive process do not allow a full-scale return to the gold standard, both at the global and national levels. Still, during the period of transformation of the international monetary system, gold can serve as an effective tool for resolving the contradictions that arise in the system.

*Our research hypothesis* is that the role of gold as "emergency" global money is growing in international monetary and credit relations, and gold can be used as a universal means of payment for the period of transformation of the international monetary system until the conclusion of a new currency agreement.

*Materials and Methods.* As the fundamental principle of understanding socio-economic phenomena and processes is their explanation through internal contradictions, the *methodological framework for our study* involves the methods of observation and data collection and analysis, based on the empirical approach to economic research, and the inductive and deductive reasoning based on two opposite, but closely related research methods. To substantiate our research hypothesis on the basis of the principles of systemic analysis, we established and described the spheres of using monetary gold in the current conditions and identified trends and prospects for the expansion of using gold as a monetary asset in international reserves.

In our opinion, the trend of a temporary return to the gold-exchange standard in international settlements is already evident. An example of this trend is the requirement of the Basel Committee on Banking Supervision to raise the status of monetary gold. According to the new rules for the bank capital formation in compliance with the Basel III standards, gold is reclassified as a Tier-1 asset carried on the books at 100% of its market value, which increases the demand for monetary gold, as opposed to the Fed bonds. This step was preceded by statements of major experts in the banking sphere on the return of gold to the sphere of monetary circulation. Thus, in September 2012, the management of Deutsche Bank AG expressed their concern over the threat to the interests of the Fed as an issuer of US dollars that is posed by the observed transformation of gold from a "valuable commodity" into a "monetary asset". Their concern was shared at the moment by Federal Reserve Chairman Ben Bernanke. Trying to slow down the transformation of the existing monetary system and to keep the US dollar in the status of the world reserve currency, he once again came up with a standard set of arguments against "gold money" (5). Under pressure from the Federal Reserve, a number of leading American banks issued statements that the new Basel III capital standards were too burdensome for credit institutions. They were later joined by European banks, which declared — partly for objective reasons, and partly in solidarity with the American banks — that they were not prepared for transition to the new banking standards. However, most experts agree that many banks in the US, Europe and other parts of the world are prepared for Basel III standards, as they have already accumulated the required amount of buffer capital in the form of monetary gold. Among the banks that are prepared for transition to the new standards of capital and liquidity management, there are banks of both leading exporters and producers (South Africa, Canada and Australia) and importing buyers of the refined gold (Hong Kong, Switzerland, Saudi Arabia and India).

Another fact confirming our hypothesis is the escalating process of "dumping" US dollar assets by central banks to buy gold (resulting in a decrease in the US dollar share in the international reserves of many countries, including the Russian Federation). According to the World Gold Council (WGC), the global demand for gold in 2019 amounted to 4,355.7 tons, and 401.1 tons of investment gold were sold, which exceeded the 2018 volumes by 4 times (+426%) (6).

This trend led to an increase in gold prices at the end of 2016. An attempt to stop this trend with another interest rate increase, announced by Fed Chairman Janet Yellen and carried out in 2017 (for the third time over the past years), did not produce the desired effect (7). In any case, such measure can only give a short term gain, as an increase in the interest rate has a negative impact on the economy of any country, which makes its liberalization inevitable. In our opinion, this circumstance, against the background of the ongoing global financial and economic crisis entering a latent phase, gave new impetus to flight into gold among most potential investors, which contributed to the return of the upward trend in monetary gold quotes in the world market. Thus, in 2017 the average annual price of gold per troy ounce was $1257.53 as compared to $1250.74 in 2016, but in 2018 it amounted to $1268.49, and in the first quarter of 2019 — $1298.0 (8; 9).

"Return to the golden past" is of great interest for such countries as Switzerland, which is developing a project to introduce a "parallel" currency (gold franc) for circulation within its territory. Asian countries are no less active in their interest in introducing money backed by gold. Dr. Mahathir bin Mohamad, Prime Minister of Malaysia, suggested that Asian countries should consider introduction of a gold dinar as a common regional currency, and this idea is still actively discussed. China stands apart from other countries, always being one of the "gold leaders" in sale or purchase of the refined gold, depending on the current market situation and the internal needs. In Turkey, the banking sector is de facto ready to comply with Basel III standards. According to the UK edition of the Financial Times, the policy pursued by Turkey's Central Bank Governor Erdem Başçi turned out to be quite effective: in 2018, Turkish banks were able to raise 8.3 billion US dollars against the collateral of gold bullions for lending purposes. Similar processes are observed in Africa and other regions of the world (10). So, the world banking community is gradually "trying on" the terms of the gold standard. We assume that the main reason for the current situation is the dependence of most national currencies on the US dollar, and, consequently, the increased dependence of the countries issuing these national currencies on the "American patronage".

Another new trend in the international monetary system, which also confirms the increasing role of gold, is that central banks are repatriating national gold assets from depositories in other central banks and world gold vaults. In this context, the initiatives to repatriate gold bullions deposited by European and some other countries in Fort Knox seem to be especially indicative. Thus, about 100 tons of gold bullions were returned from the USA to the Netherlands, 300 tons were returned to Germany, Turkey returned all of its monetary gold previously stored in the United States, etc. (11, 12). The main driving force behind this process is dissatisfaction with the Fed's policy of pressure on the euro and other currencies by manipulating rates, as well as the increase in geopolitical risks. All these factors determine the desire of the world community to reduce the dependence of economic relations on the US dollar. "Gold is a market with an annual turnover of over 8 trillion US dollars. It is a liquid asset that can always be quickly sold. And it is an asset that you can control. If your billions are stored on Pravda Street [in a gold vault in Moscow], you don’t take orders from America" (13).

The analysis of historical data shows that the increase in quotes of monetary gold is a fairly accurate indicator of an approaching monetary and financial crisis or its intensification. The current situation is characterized by an accelerated growth of prices for gold assets, especially for physical gold, which makes it possible to foresee the approach of a new "round" of the crisis predicted by many authoritative experts. This conclusion is confirmed by the analysis of the retrospective dynamics of the global gold prices from 2000 to 2020 (Fig. 1).

Analysis of the curve of global prices for monetary gold shows that the prices fluctuated within the normal range of market correction during the period before the last global financial and economic crisis (approximately until 2004), but since 2005, when the approach of the crisis became obvious, global prices for gold began growing quite actively, and during the crisis peak (2008–2012), gold prices increased by almost 10 times in comparison with 2002–2003.


**Figure 1.** Dynamics of prices for monetary gold on international markets
(Source: https://goldomania.ru/menu_003_003.html)

When the crisis subsided, the global prices for monetary gold began declining rather rapidly (by 2016, gold quotes on the global markets reduced by almost 2 times compared to 2012). However, later on, the prerequisites for a new financial crisis were already formed (increased terrorist threat, political instability on a global scale, trade wars, coronavirus pandemic, etc.), and the global monetary gold market reacted with a new wave of increase in gold quotes. During the period from the end of 2019 to mid-2020, the current quotes reached the level of $1,500, and on July 27, gold prices hit an all-time high when the price for the metal soared to $1,911.7 per ounce. Since then, gold prices have continued going up (14).

*Results.* Our study revealed a number of reasons for changes in the behaviour of central banks in the gold market.

1. An increased volatility of exchange rates and the level of foreign exchange and credit risks due to the debt crisis in Europe made it necessary for central banks to diversify their official reserve assets.
2. Fiat currencies are just symbols of value secured by investor confidence, but when it is eroded by unjustified decisions by monetary authorities, their purchasing power is declining. Under such conditions, only gold, which has an intrinsic value, becomes a secure form of storing national reserves.
3. When economic sanctions are introduced and economic assets are frozen, an increase in the share of gold in international reserves helps to strengthen the political and financial security of countries under sanctions.

Gold provides central banks with opportunities to manage their portfolios of gold and foreign exchange reserves, choose low-profitable but less risky transactions and use them as a resource for financing the deficit in the balance of international settlements, preventing default on obligations to external creditors, etc. The most common transactions are SWAPs, lending and borrowing of physical gold (gold leases) and deposit transactions.

Central banks also use gold for the following:

— as collateral for loans or purchases;
— as a source for repaying external debt;
— as a source for financing imports.

Thus, the continuing role of the gold reserve as a highly liquid asset in the structure of national reserves, which can be mobilized in the event of a crisis and used to resolve external and internal problems, is also one of the signs of the ongoing transformation of the international monetary system. It is for this reason that the gold reserves of many countries are not only preserved, but are being replenished amid the increased volatility in the global currency and financial markets.

*Discussion.* According to Prof. L.I. Krasavina, the future of gold depends the attitude chosen by international monetary organizations to resolve the contradiction between the fact that gold was officially excluded from the Jamaica Accords but is actually used as an international reserve asset (15). To assess the current trends, it is necessary to consider in retrospect the motives for regulating the gold market, and, first of all, the measures taken by the world community within the framework of the Washington Agreement on Gold, which expires this year (16).

At the end of the 20th century, the opinion prevailed in the financial and banking sectors about the need to optimize the gold and foreign exchange reserves of central banks, determining the real share of gold required to

stabilize the national currency, and to get rid of the "surplus gold" as an idle asset by selling it on the international markets. In order to prevent the collapse of the global gold market, it was decided to limit the annual volume of gold offered for sale on international markets for the period of five years under a special agreement. So, in September 1999, the First Washington Agreement on Gold, or the Agreement of 15, was signed in Washington, D.C. The agreement was renewed several times with some adjustments and additions. The latest revision came into force on 27 September, 2014. A specific feature of that agreement version was the statement on recognition of the role of monetary gold as an important element of global monetary reserves. The agreement was valid until the end of 2019.
Thus, it was possible to protect the international gold markets from drastic quote fluctuations and maintain their growing trend during 15 years: private and corporate investors sought to accumulate gold as a means to ensure their wealth, to protect their capital from inflation and currency fluctuations, and to diversify their savings (17).

Gold continues to attract investors with its high liquidity and reliability as a reserve asset. However, the events of the last decade, reflecting the persistent high instability in the global economy, radically changed the situation in the global gold market, as central banks turned from sellers to buyers of monetary gold. This did not lead to market destabilization, but, on the contrary, contributed to preserving the growing trend in gold quotes, as the market was filled with primary metal from its main traditional suppliers, including China, Australia, USA, Canada, Russia, South Africa, Peru and Brazil (18).

2016 was marked by a new trend of a reversal of gold sales from the external to the domestic market (the monetary gold produced by national subsoil users was purchased by the central banks of China, Russia, Canada, Brazil and some others countries) (19), changes in the vector of investors' interests (except for central banks) and their focus on stock markets, as well as on cryptocurrency markets (20). The central banks are comfortable with the low rate of changes in gold quotes, as none of them is interested in a sharp reversal of the market.

Another significant indicator of the beginning transformation of the international monetary system and the role of the monetary gold in this process is the introduction of a golden anchor for electronic money (digital gold currencies) and so-called stablecoins (cryptocurrencies backed by real assets, primarily monetary gold).

The analysis shows that, during the period of the financial and economic crisis, the introduction of gold backing for electronic money provides it with significant advantages over other currencies, as private investors have traditionally had trust in gold. The banks, which have not only reserves of refined gold but also sufficient regulative support and the qualified personnel, are best prepared for the mass emission of digital gold currencies.

With their increased use, the investments in them will grow, as well as demand for them, as such currencies (at least at the first stage) will be 100% backed by physical gold or financial instruments nominated and backed by gold. Media sometimes figuratively use the term "digital gold" for cryptocurrencies, which does not reflect their economic substance, as cryptocurrencies for the most part are unsecured assets used for intermediate settlements. Besides, the term has already been consistently used to denote gold-backed electronic money.

At the same time, the cryptocurrency market is now developing very actively. The cryptocurrencies that can be exchanged for gold (backed by monetary gold) are of greatest interest to players in the market. Possibility of exchange is not the same as purchase and sale transaction, as the exchange transaction is only possible in such cases as, for example, sales of collateral (pledged assets) used to secure a loan (21). Therefore, such cryptocurrencies as Stablecoin do not perform the monetary function of exchange (cryptocurrency is not money), but they are means to attract investments.

To date, several dozen cryptocurrencies backed by monetary gold have entered the market, including the following: Tether Gold (XAUT) is the most popular gold-backed token with the total market capitalization of over 26 million USD dollars; Pax Gold (PAXG) has the total market capitalization of over 18.5 million USD dollars; Xaurum (XAUR) — over 3.5 million USD dollars (22). A group of Russian entrepreneurs launched the GoldMint blockchain platform with the Gold cryptocurrency, the rate of which is tied to the price of gold. Such projects are also considered by other big Russian corporations (23).

*Conclusion.* Now it is still difficult to assess the importance of the considered events for the international monetary system, but to some extent they substantiate our thesis: money in its classical understanding is just a special case of the economic phenomenon that can be tentatively called "an accumulator of potential exchange opportunities" or, breathing new life into an old definition, a "universal equivalent" of exchange in a broader sense. The thesis requires a convincing theoretical substantiation, which stimulates us to continue research.

Nevertheless, we consider that other currency assets cannot replace gold as "emergency" global money during the period of transformation of the international monetary system. Gold is gradually becoming an international reserve asset, or rather it regains this function. Today gold accumulation can protect against currency risks and insure against negative consequences of sanctions, as monetary gold has the ability to retain its value, becoming a generally recognized means of exchange during any potential financial, economic and political crisis. According to the management of the Bank of Russia, the growth of the gold share in the Russian international reserves resulted in an obvious international process of gold monetization (24).

As stated by First Mining Gold founder Keith Neumeyer ???], "I'm certain that a global reset will take place when the governments of the world need to rid themselves of debt, and that they will tie everything to the price of gold. That’s why countries like Russia and China are accumulating gold — they know what may happen a few years from now" (25).

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